

**Management Letter Related to the Audit of the  
Foreign Service Retirement and Disability Fund  
2007, 2006, and 2005 Financial Statements**

**AUD/FM-08-27, June 2008**

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March 25, 2008

To the Assistant Secretary for Resource Management and Chief Financial Officer and the Director General of the Foreign Service and Director of Human Resources of the U.S. Department of State:

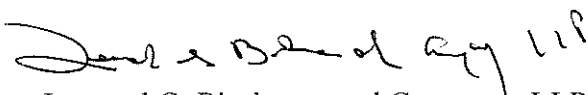
We have audited the financial statements of the Foreign Service Retirement and Disability Fund (FSRDF) for the years ended September 20, 2007, 2006, and 2005, and have issued our report thereon dated March 25, 2008. In planning and performing our audit of FSRDF's financial statements, we considered internal control over financial reporting to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on internal control. We have not considered internal control since the date of our report.

Our audit procedures were designed primarily to enable us to form an opinion on the financial statements and therefore may not identify all weaknesses in internal control that may exist. However, we would like to take this opportunity to use our knowledge of FSDRF gained during the audit to provide comments and suggestions that we hope will be useful to you.

Although not considered to be material weaknesses or significant deficiencies, we noted certain matters involving internal control and other operational matters that are presented in Attachment 1 of this letter for your consideration. These observations are intended to improve internal control or result in other operating efficiencies.

This report is intended solely for the information and use of the Office of Inspector General, FSRDF management, and others within the organization and is not intended to be, and should not be, used by anyone other than these specified parties.

The Bureau of Resource Management's comments on this report are presented as Attachment 2.

  
Leonard G. Birnbaum and Company, LLP

Attachments: As stated.

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Observations and Recommendations

1. Overpayments to Annuitants (Debt Collection Act of 1982)

While testing FSRDF benefit payments during the audit of the Department of State financial statements, we noted that the Bureau of Resource Management's Retirement Accounts Division did not always establish an accounts receivable in a timely manner after the discovery of overpayments to annuitants.

In addition, while the Department of State has made agreements for annuitants to pay back their overpayments, it appears that they have not followed up on these overpayments, which date back to FY 1995.

*We recommend that the Bureau of Resource Management establish accounts receivable for collection of overpayments to annuitants as soon as overpayments are discovered.*

*We recommend that the Bureau of Resource Management follow up on agreements made with annuitants to pay back overpayments.*

2. Foreign Service Retirement and Disability Fund's Actuarial Liability

Our actuary reviewed FSRDF's September 30, 2007, actuarial valuation report, which includes both the Foreign Service Retirement and Benefit System (FSRDS) and the Foreign Service Pension System (FSPS), and made several observations as follows:

- The fund has earned less than the actuarially assumed rate in each of the last four years, and the rate of return is decreasing. If this trend continues, future funding requirements will increase.
- The assets for FSRDS exceed the value of all future benefits for FSRDS. FSRDS continues to receive significant contributions that the plan may not need. It may be appropriate to use some of the future contributions to accelerate the funding of FSPS or for other purposes.
- The report shows that the employer normal cost percentages (23.10 percent for FSRDS and 24.03 percent for FSPS) did not change from last year. While this is possible, it would be unusual for both plans to experience no change in the normal cost rate.

In addition, our actuary provided a number of suggestions on how the Department could improve its actuarial report related to FSRDF as follows:

- The report could have included separate amounts for interest and benefit payments in the statement of changes in the present value of accumulated plan benefits.
- The report could have shown the development of the normal cost percentage.
- The report could have included information about future cash flows and/or future benefit payments.
- The report could have shown the rate of return of assets.
- The report shows an actuarial loss of \$87.5 million. It would be useful to show separately the major components of the loss (e.g., investment return, salary increases, and mortality).
- Additional details regarding the method used to determine the amortization of unfunded liability would help users.

*We recommend that the Department consider the suggestions provided by the independent actuary during future actuarial assessments.*



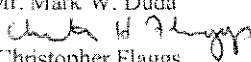
**United States Department of State**

*Deputy Chief Financial Officer*

*Washington, D.C. 20520*

May 27, 2008

**MEMORANDUM**

TO: OIG/AUD – Mr. Mark W. Duda  
FROM: RM/DCFO – Christopher Flaggs   
SUBJECT: Draft Independent Auditor's Report (Report) on the Foreign  
Service Retirement and Disability Fund's 2007, 2006, and 2005  
Financial Statements and Management Letter

We have reviewed the subject draft Report and Management Letter, and have no substantive comments. We are pleased to receive an unqualified opinion on the FSRDF's financial statements which comprise about one-third of the Department's \$45 billion in assets and three-fourths of the Department's \$20 billion in liabilities. In regards to the Management Letter, we will work with our actuary to implement the Independent Auditor's observations and suggestions on improving the FSRDF's actuarial report.

We thank you for the opportunity to comment on the draft Report and extend our appreciation for the professional manner in which Leonard G. Birnbaum and Company and your office conducted the FY 2007 audit.

CC: Mr. Bradford R. Higgins  
Mr. James L. Millette  
Mr. Phil Schlatter  
Ms. Gayle Voshell